

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
FORD MOTOR CREDIT COMPANY	:	
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Years	:	
1976, 1977 and 1978.	:	

DETERMINATION

In the Matter of the Petition	:	
of	:	
FORD LEASING DEVELOPMENT	:	
COMPANY	:	
for Redetermination of a Deficiency or for	:	
Refund of Corporation Franchise Tax under	:	
Article 9-A of the Tax Law for the Years	:	
1976, 1977 and 1978.	:	

Petitioner Ford Motor Credit Company, The American Road, Dearborn, Michigan 48121, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1976, 1977 and 1978 (File No. 802173).

Petitioner Ford Leasing Development Company, 300 Renaissance Center, P.O. Box 43317, Detroit, Michigan 48243, filed a petition for redetermination of a deficiency or for refund of corporation franchise tax under Article 9-A of the Tax Law for the years 1976, 1977 and 1978 (File No. 802172).

A consolidated hearing was held before Arthur S. Bray, Administrative Law Judge, at the offices of the Division of Tax Appeals, W.A. Harriman Campus, Albany, New York, on February 29, 1988 at 1:15 P.M., with all briefs to be submitted by June 16, 1988. Petitioners appeared by DeGraff, Foy, Conway, Holt-Harris and Mealey (James H. Tully, Jr., Esq., of counsel). The Audit Division appeared by William F. Collins, Esq. (Thomas C. Sacca, Esq., of counsel).

ISSUE

Whether promissory notes executed by petitioners, which by their terms were payable on demand or within one year, were renewed so as to be outstanding for more than one year.

FINDINGS OF FACT

1. Petitioner Ford Motor Credit Company is the captive finance company of Ford Motor

Company. Its predominant business is the financing of retail purchases of automotive vehicles from Ford Motor Company. During the audit years, petitioner Ford Leasing Development Company provided wholesale financing of lease cars to Ford dealerships.

2. In order to raise capital to operate their businesses, petitioners entered into short-term borrowing agreements with the trust departments of various banks, such as Morgan Guaranty Trust Company and Manufacturers Hanover Trust Company. These agreements were executed by the banks, acting as fiduciaries for the estates, trusts and pension funds they managed.

3. Once entered into, a short-term borrowing agreement remained in effect until terminated by one of the parties. A typical agreement included the following provisions:

(a) At any time and from time to time, the lender could offer to lend funds to the borrower (either Ford Credit or Ford Leasing) who was free to borrow all or a portion of the funds offered. Loans were to be made in multiples of \$1,000.00.

(b) Each outstanding loan was to bear interest at a rate which was the equivalent of the rate adopted by the borrower as the discount rate for its 180-day commercial paper.

(c) All loans made during the months of January through June of each year were to be repaid in full on the next succeeding July 1, and all loans made during the months of July through December were to be repaid in full on the next succeeding January 1. At any time, the lender had the right to demand payment of all or a part of the principal amount of the loans outstanding. At any time, the borrower had the right to repay all or a part of the principal amount of the loans outstanding.

(d) Upon the making of the initial loan, the borrower was to issue and deliver to the lender its promissory note in the amount of the initial loan. Each time an additional loan was made or repaid, an appropriate entry was to be made on the note under the column "principal amount outstanding". Upon the lender's request, the borrower would issue and deliver to the lender a new promissory note in exchange for the note then held by the lender. The new note was to be in an amount equal to the then outstanding principal amount of the note being surrendered by the lender. Each note was to be dated as of its issue and was to mature on the earlier of July 1 or January 1 next following the date of issuance.

4. In practice, petitioners would issue and deliver a new promissory note to a lender every six months. When the new note was exchanged for the note being surrendered, the lender stamped the surrendered note "cancelled" or "paid". The new note was executed in an amount equal to the outstanding principal amount of the note being surrendered.

5. In the management of the trust accounts for which they acted as fiduciaries, the bank trust departments used the short-term borrowing agreements as a short-term haven for cash. As a result, a single trust account might move cash in and out of a short-term borrowing agreement several times during the six-month term of a promissory note.

6. The total amount available for borrowing under the terms of a short-term borrowing agreement was determined by the aggregate amounts invested by the trust accounts. A single trust account's participation in a short-term borrowing agreement might fluctuate considerably in a six-month period. Petitioners' liabilities under the terms of the agreement would also fluctuate in that period, but to a lesser extent.

7. As evidence of the intentions of the parties regarding the significance of the replacement of an old promissory note with a new one, petitioners submitted a letter from a vice-president of Manufacturers Hanover Trust Company. It states:

"To the extent that the old, extinguished note may be replaced by a new master note, such replacement constitutes payment of the old note as far as the holders of interests in the old note are concerned."

8. In calculating their business capital for purposes of the New York State corporation franchise tax, petitioners excluded liabilities incurred under the terms of the short-term borrowing agreements. On audit, the auditors concluded that liabilities outstanding for more than a year should have been included in each petitioner's business capital tax base. Adjustments were made accordingly, and as a result, the Division of Taxation issued the following notices of deficiency:

(a) On April 9, 1985, three notices were issued to Ford Leasing, asserting tax deficiencies of \$22,409.00 for 1976, \$19,643.00 for 1977 and \$15,657.00 for 1978.

(b) On April 10, 1985, three notices were issued to Ford Credit, asserting tax deficiencies of \$18,423.00 for 1976, \$66,608.00 for 1977 and \$53,217.00 for 1978.

9. Petitioners paid the asserted tax plus interest and timely filed claims for refund or credit of the amounts paid.¹ The basis of their refund claims was their contention that the liabilities resulting from the short-term borrowing agreements were deductible from their business capital tax bases because: (1) the loans made pursuant to the short-term borrowing agreements were payable by their terms on demand or within one year from the date the liability was incurred; and (2) the liabilities incurred under the terms of the agreement were in fact paid within one year from the date they were incurred.

10. On March 6, 1985, the Division denied petitioners' claims for refund on the ground that the promissory notes evidencing the loans were renewed every six months so as to be outstanding for more than one year.

CONCLUSIONS OF LAW

A. New York imposes a franchise tax on every corporation doing business in the State (Tax Law § 209.1). Every corporation subject to the tax so imposed is required to pay a tax calculated by whichever of four alternative methods results in the greatest tax (Tax Law § 210.1). The alternative used by petitioners for measuring the tax is based on the total of business capital and investment capital allocated to New York State (Tax Law § 210.1[a][2]). The term business capital means the total average fair market value of those assets of a corporation that are neither subsidiary capital nor investment capital, "less liabilities not deducted from subsidiary capital or investment capital which are payable by their terms on demand or within one year from the date incurred" (Tax Law § 208.7; 20 NYCRR 3-4.3[a]).

¹Tax and interest due were actually paid before the notices of deficiency were issued. The notices show credit given for taxes paid and no balances due.

Deductible liabilities include those general liabilities incurred in the course of a business's operation during a report period, including: accounts payable, wages payable, accrued taxes, accrued expenses, accrued interest, and notes and other written obligations if they are payable by their terms on demand or within one year from the date incurred (20 NYCRR 3-4.3[a]). Corporate notes and other written obligations, which may appear to be current by their terms, may not be deducted from business capital if they are in fact extended beyond one year (Matter of Thico Plan, Inc., State Tax Commission, May 26, 1970; 20 NYCRR 3-4.3[b]).

B. It is the Division's position that the promissory notes executed under the terms of the short-term borrowing agreements were renewed so as to be outstanding for more than one year as of any date during the year covered by petitioners' corporation franchise tax reports.

Petitioners maintain that the liabilities evidenced by the promissory notes were not outstanding for more than one year. They rely on two related factors to support their position. First, they note that the lenders with whom they entered into short-term borrowing agreements were the individual trust accounts managed by the banks, the banks merely acting as fiduciaries for these accounts. Since each trust account moved in and out of the notes executed under the terms of the agreement, the trust accounts participating in a note at the beginning of a six-month term were not necessarily the same accounts as those participating at the end of the term. Petitioners then view their liabilities as a series of small loans constantly made and repaid, within the six-month term. Related to this argument, and also forming an independent basis of a second argument, is the fact that a prior note was marked "paid" or "cancelled" when it was surrendered and replaced by a subsequent promissory note. Petitioners maintain that this fact independently establishes that subsequent notes were intended to be and were accepted by the lenders as payment of the debt incurred by the prior note. Furthermore, it is their position that replacement of the old note with a new note constituted payment of the old note, as concerned the individual trust accounts participating in the old note.

C. Petitioners' first argument places too much emphasis on the structure of the investment instrument as it concerned the individual trust accounts and not enough emphasis on the nature of the liability incurred by petitioners. In a memorandum to the legislature, the Department of Taxation and Finance stated:

"The amendment to paragraph 7 of Section 208 is designed to make clear that in ascertaining the amount of business capital subject to tax liabilities consisting of loans or advances outstanding for more than one year are not deductible." (1948 NY Legis Ann, at 290.)

The relationship between petitioners' liabilities under the terms of the short-term borrowing agreement and an individual trust account's investment in that agreement was too attenuated to support the conclusion that petitioners' liabilities were outstanding for less than a year. From the point of view of a single account, petitioners may have incurred and satisfied a liability, at any time or from time to time within a six-month period. However, when the focus is placed on petitioners, it can be seen that their liabilities remained fairly constant over time. The determinative question then is whether petitioners actually satisfied their liabilities by the issuance of new promissory notes which were accepted by the lenders in exchange for the original note.

D. Generally, a promissory note is delivered and accepted as evidence of a debt rather than in payment of it (Industrial Bank of Commerce v. Shapiro, 276 App Div 370, 372, affd

302 NY 566). Whether the taking of a new note constitutes payment of the original note or is merely a renewal or extension of it depends largely on the intentions of the parties. Unless there is an expressed agreement or understanding that the new note is received in payment of the old, the presumption is that the new note is a renewal of the old, even though the first instrument is marked "paid" or "canceled" (*Industrial Bank of Commerce v. Shapiro, supra*; *Garfield National Bank v. Wallach*, 223 App Div 303).

E. Petitioners have not offered sufficient evidence to overcome the presumption that the new notes constituted renewals or extensions of the older notes. This conclusion is supported by three factors. First, under the terms of the short-term borrowing agreements, the initial promissory notes were intended to serve as evidence of loans made within a six-month term. The terms and conditions under which loans were made and repaid were all contained in the agreements. The short-term borrowing agreement did not expressly provide that the taking of a new note by the lender would constitute payment of the old note. Second, that the promissory notes were payable by their terms on demand or six months from the date the note was executed is irrelevant where the liabilities incurred by petitioners under the terms of the short-term borrowing agreement extended beyond one year. Finally, as noted above, the lender's acceptance of a new note and its marking of the old note "paid" or "cancelled" did not in itself constitute payment of the original instrument. "A debt is not honestly extinguished till it is paid in cash" (*Industrial Bank of Commerce v. Shapiro, supra*). It is concluded that subsequent promissory notes issued by petitioners were merely extensions or renewals of the initial notes and that, as a consequence of those renewals or extensions, the liabilities incurred under the terms of the short-term borrowing agreements were outstanding for more than one year.

F. The petitions of Ford Motor Credit Company and Ford Leasing Development Company are denied, and the denials of refund or credit issued on March 6, 1985 are sustained.

DATED: Albany, New York

October 20, 1988

/s/ Arthur S.

Bray _____
ADMINISTRATIVE LAW JUDGE